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External debt sustainability and development

Report of the Secretary-General

Summary

The present report, submitted pursuant to General Assembly resolution 64/191, reviews recent developments regarding the external debt of developing countries, with a special focus on the impact of the current global financial and economic crisis on external debt sustainability. The report discusses policies and institutions aimed at reducing the prevalence and costs of debt crises. It describes progress on debt relief and official development assistance and analyses new trends and modalities in multilateral financing.

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I. Introduction

1. The present report is submitted to the General Assembly in accordance with paragraph 39 of Assembly resolution 64/191. It includes a comprehensive analysis of the external debt situation and debt-servicing problems of developing countries and countries with economies in transition. It describes new developments and trends in the areas of external debt and development finance and provides a basis for the deliberation of related policy issues.

II. Recent trends

2. The dollar value of the total external debt of developing and transition economies (henceforth referred to as developing countries) increased by 8 per cent from 2007 to 2008, but stabilized at around $3.7 trillion in 2009 (see annex). The debt-servicing burden rose by more than 11 per cent between 2007 and 2008 (data for 2009 are not yet available).

3. The economic crisis led to a drop in the dollar value of both exports and gross national income (GNI). As a consequence, the average external debt-to-export ratio of developing countries increased from 64 to 82 per cent, and their external debt-to-GNI ratio went from 22.0 to 23.5 per cent. This was a substantial setback, as it reversed some of the advances achieved during the 2000-2008 period, when debt dropped from 133 to 64 per cent of exports of goods and services and from 37 to 22 per cent of GNI.

4. The debt-to-export ratio increased by 45 percentage points in Eastern Europe and Central Asia, 26 points in Latin America and the Caribbean and 17 points in Sub-Saharan Africa. The least affected regions were East and South Asia, where the debt-to-export ratio increased by approximately 7 percentage points.

5. The global crisis also had a significant effect on low-income countries. Their GNI for 2010 is expected to be 5 per cent lower than the pre-crisis estimate. The difference between the pre-crisis and post-crisis estimates increases to 8 per cent, however, for small low-income economies with a population smaller than 5 million. This difference is also substantial for Latin America and the Caribbean (approximately 7 per cent) and Sub-Saharan Africa (6 per cent). However, the largest impact of the crisis was felt in Eastern Europe and Central Asia. This region which, in the years before the crisis had witnessed a rapid economic expansion fuelled by private sector borrowing (see A/64/167), now faced a collapse in growth. This contraction in output led to an increase in its external debt, from 37 to 48 per cent of GNI.

6. A recent International Monetary Fund/World Bank analysis of the effect of the crisis on debt sustainability in low-income countries found a substantial negative temporary effect accompanied by a smaller effect in the long run. The findings rely on the assumptions that the crisis will have no impact on long-run economic growth, that the recovery will be rapid and that the affected economies will continue to have access to adequate financing and will resume the macroeconomic policies adopted before the crisis. Some small, vulnerable middle-income countries are also facing acute debt problems because of the crisis.

7. In 2009 developing countries as a group continued to accumulate international reserves, which by the end of the year surpassed $4.8 trillion. However, there are large differences across regions and countries. Although the East Asia and the Pacific and Middle East and North Africa regions hold reserves that are much larger than their external debts, in Eastern Europe and Central Asia and Latin America and the Caribbean, international reserves are about 50 per cent of total external debt.

8. Capital flows to emerging markets decreased substantially after the bankruptcy of Lehman Brothers in September 2008 and did not recover until March 2009. This swing in capital flows also led to large movements in exchange rates and to a sudden increase in the cost of borrowing. Emerging market interest rate spreads, which stood at approximately 300 basis points in August 2008, peaked at 760 basis points in December 2008. It then took almost a year to go back to pre-bankruptcy levels. While spreads are now low, borrowing costs may increase again if debt accumulation in the advanced economies crowds out developing country borrowers.

9. In general, high reserve coverage increased the resilience of developing countries to those liquidity shocks. Reserve coverage varies across countries, however, and it is limited and rapidly decreasing in some small and vulnerable economies.

10. The crisis also led to a reversal in the trend towards more borrowing from private lenders and more external borrowing by the private sector. In 2009, the share of long-term external debt owed to private lenders dropped by almost two percentage points (from 75.6 to 74.0 per cent), and the share of long-term external debt owed by private sector borrowers went from 51.6 to 49.8 per cent. This reversal was the result of expansionary fiscal policies, which increased the share of public sector borrowing, combined with the partial drying up of private financial flows, which required an increase in official lending. Gross commitments by the International Monetary Fund (IMF) increased substantially, from $1.3 billion in 2007 to nearly $120 billion in 2009. About 70 per cent of this increase ($80 billion) was for the new flexible credit line facility. However, only $3 billion of that amount was allocated to low-income countries through the Poverty Reduction and Growth Facility and the Exogenous Shock Facility. The remaining $36 billion consisted of standard standby arrangements.

11. The World Bank also increased gross commitments, from $36.5 billion in 2008 to $65 billion in 2009. Most of the increase was for International Bank for Reconstruction and Development loans targeted to middle-income countries; International Development Association commitments, which benefit low-income countries, increased by only $1 billion. Gross commitments from the Asian Development Bank, the African Development Bank, the European Bank for Reconstruction and Development and the Inter-American Development Bank went from $33 billion in 2008 to $50 billion in 2009.

12. The share of total long-term external debt owed to private lenders remains high in Eastern Europe and Central Asia (92 per cent) and Latin America and the Caribbean (81 per cent). Eastern Europe and Central Asia is the only region in which more than 50 per cent of total long-term external debt is owed by private borrowers (the actual share is 71 per cent, down from 73 per cent in 2008). The share of private debt is instead particularly low in Sub-Saharan Africa (32 per cent of long-term external debt is owed to private lenders and 10 per cent is owed by private borrowers) and in the Middle East and North Africa (36 per cent of long-

term external debt is owed to private lenders and less than 6 per cent is owed by private borrowers).

13. The financial crises that hit several emerging market countries in the second half of the 1990s and at the beginning of the new millennium made policymakers well aware of the risks of external borrowing. As a consequence, several countries adopted policies aimed at retiring public external debt and substituting it with domestic debt (see A/62/151). That policy was successful in reducing the exposure of developing countries to the current crisis and thus in increasing their resilience. In some cases, however, policymakers used the captive domestic market to accumulate excessive debt, and some countries are now facing problems with domestic debt sustainability. A case in point is Jamaica, which launched a successful debt exchange in January 2010 for 95 per cent of its domestic public debt, amounting to approximately 60 per cent of gross domestic product (GDP).

III. The debt situation of the least developed countries

14. The group of 49 least developed countries has average debt ratios about 50 per cent higher than the overall developing country average (in 2008 the debt-to-GNI ratios were 31 and 22 per cent, respectively).

15. Over the period 2000-2008, the least developed countries as a group experienced considerable increases in international reserves, exports of goods and services and GNI and significantly improved their debt indicators. This was especially the case for the least developed countries that are highly indebted poor countries and that benefited from debt stock reductions associated with the Heavily Indebted Poor Countries Initiative and the Multilateral Debt Reduction Initiative.

16. Despite these positive developments, the global financial and economic crisis has had a considerable negative impact on the least developed countries because of contractions in economic growth, export earnings, remittances, and investment. Although 2009 debt data for all the least developed countries are not yet available, there are indications that the crisis partially reversed the gains made on the external debt front up to the end of 2008. The total external debt of African countries, 33 of which are least developed countries, increased from 22.4 per cent of GDP in 2008 to 25.4 per cent in 2009. Similarly, external debt as a percentage of exports of goods and services rose from 53.4 per cent in 2008 to 80.3 per cent in 2009, according to the Economic Commission for Africa.

17. Debt service burdens, both as a share of exports and as a percentage of government revenue, will remain more elevated into 2010 and beyond compared to the pre-crisis years. In 2009, debt service in relation to government revenue increased by more than 17 per cent in heavily indebted poor countries. This increase is due to both a rise in absolute debt service payments as well as a drop in government revenues. Even prior to the crisis, the capacity of many least developed countries to meet the Millennium Development Goals was constrained by a lack of domestic resources. The increased share of government revenues devoted to debt servicing is worrisome, as more countries are likely to fall behind on planned poverty-reduction programmes.

18. To mitigate the negative impact of the financial crisis, many least developed countries have increased public spending by digging into the fiscal cushion built up

during the previous years. However, if the economic recovery is to be delayed further, their fiscal space would be quickly exhausted. With dwindling government revenue and increasing government spending, many countries recorded large fiscal deficits in 2009. In Sub-Saharan Africa as a whole, government revenue excluding grants declined from 25.1 per cent of GDP in 2008 to 21 per cent in 2009. According to IMF, in 2009, primary balances for many Sub-Saharan Africa countries (12 out of 23) had drifted below levels required to stabilize debt ratios.

19. African countries also faced an almost across-the-board deterioration of their current account balances. For instance, there has been a reduction of current account surpluses in Angola, Equatorial Guinea and the Sudan. For oil-importing countries, such as Ethiopia and the Niger, the chronic current account deficit increased further in 2009. According to IMF, Africa is one of the few regions where the current account moved from a surplus of 2.5 per cent of GNI in 2008 to a deficit of 3.1 per cent of GNI (corresponding to about $18 billion) in 2009.

20. Least developed countries that are currently in debt distress include Comoros, the Democratic Republic of the Congo, Eritrea, Guinea, Guinea-Bissau, Liberia, Myanmar, Somalia, the Sudan and Togo. Countries at high risk of debt distress include Afghanistan, Burkina Faso, Burundi, Djibouti, the Gambia, Haiti, the Lao People's Democratic Republic, Maldives, Sao Tome and Principe and Yemen.

21. The international community must avoid complacency and remain vigilant in monitoring the debt situation of the least developed countries and take steps to ensure that grant and concessional financing is readily available. Over the medium term the demand for such financing is expected to remain high, as countries grapple with the negative repercussions of the global crisis. Most least developed countries do not have access to capital from international financial markets, making concessional loans and grants crucial forms of financing for development.

IV. Policies aimed at mitigating the prevalence and costs of debt crises

22. Debt crises are often caused by the interaction between solvency and liquidity problems.

23. For private borrowers, the definition of solvency is straightforward: an entity is insolvent when its liabilities are larger than its assets. There is no agreement, however, on the exact meaning of solvency for sovereign borrowers. Focusing on the "internal transfer" problem (i.e., on the need to transfer funds from the private to the public sector), solvency problems arise when the interest bill exceeds a Government's ability to generate current and future primary budget surpluses.[1] Countries with foreign currency debt also need to deal with an "external transfer" problem, which relates to the ability of generating the hard currency necessary to service the debt.

[1] This definition does not require the ability to repay the debt, but just to stabilize the debt at a ratio at which it can be continuously serviced. To be more precise, debt becomes explosive (and thus non-sustainable) when the primary surplus (i.e., the budget surplus net of interest payment) as a share of GDP is smaller than the effective interest bill (i.e., the debt-to-GDP ratio times the difference between average interest rate and output growth). Countries in which growth exceeds the interest rate on public debt can remain solvent even in the presence of a primary deficit.

24. It is difficult to assess whether a given country has space for increasing its debt (possibly to finance high-return investment projects or to provide much-needed social services) or whether the country's debt level is already too high. This problem is compounded by the fact that the threshold at which debt becomes unsustainable is country-specific. Since there is no consensus on which factors determine this threshold, there can be multiple equilibria driven by the volatile and self-fulfilling perceptions of market participants. The same investors who at one moment are willing to pour enormous financial resources into a country can suddenly decide that the country's debt has become unsustainable and, by rushing to the exit, may cause a sudden increase in the country's borrowing cost and possibly validate the perception.

25. Moreover, debt sustainability is a forward-looking concept that requires long-run projections on several macroeconomic variables (i.e. output growth, tax rates, interest rates, commodity prices and the real exchange rate). However, in the volatile macroeconomic environment that characterizes most developing and emerging market countries, any projection beyond the three- to four-year horizon is almost meaningless.

26. Finally, any analysis of debt sustainability should recognize the need to achieve the Millennium Development Goals without increasing debt ratios (see A/59/2005, para. 54) and acknowledge that public expenditure may have a direct effect on the variables that determine debt sustainability. For instance, an increase in public investment may increase potential growth and thus have a positive effect on sustainability.

27. The last two decades have shown that access to the international capital markets is a double-edged sword for many developing countries. On the one hand, the inflow of capital may allow buying more or cheaper imports for some time. On the other hand, inflows, in particular short-term inflows of speculative capital, tend to cause an appreciation of the domestic currency and a deterioration of the international competitiveness of the whole country. This leads to large current account deficits and unsustainable debt. Once financial markets lose confidence in the ability of the country to repay its debt, or if the country is subject to contagion from other markets, the turnaround of capital flows may push the country into a financial and currency crisis. These types of crises are also related to debt structure and are less of a concern for countries that can borrow in a currency they can print (because the central bank can provide the necessary liquidity). Maturity also matters, because countries that issue long-term debt have smaller rollover needs.

28. In this situation, and because of the lack of a coherent international monetary system, most countries need international assistance to stop their currency from falling because their own reserves are too small to intervene successfully. Although some conditions may be needed to restore confidence and manage an orderly depreciation, assistance from the international financial institutions has often come with across-the-board conditionality that imposes unnecessary painful fiscal and structural adjustments. In fact, there is normally no conditionality imposed by the traditional domestic lender of last resort, the central bank, because the objective is to bridge a period of uncertainty and "animal spirits" in the financial markets but not to impose any change in the behaviour of borrowers and lenders in the long term.

29. Until recently, liquidity crises affected mostly financially globalized economies, which borrow in foreign currency from the international capital market, and spared low-income countries, which rely on more stable official financial flows.

However, the process of financial globalization is rapidly expanding to middle- to low-income countries (the so-called frontier markets), making those countries subject to potential liquidity shocks.

Evaluating debt sustainability

30. Even though there is no consensus on the threshold at which debt becomes unsustainable, it is plausible that, all else being equal, the lower the level of debt, the more likely it is that a country will avoid a debt crisis. Therefore, the starting point of any policy aimed at avoiding debt crises and maintaining debt sustainability should be avoiding unnecessary debt accumulation.

31. Implementing such a policy requires a better understanding of what constitutes "unnecessary" debt accumulation.[2] A project of the United Nations Conference on Trade and Development (UNCTAD) aimed at building consensus around a set of principles for responsible borrowing by and lending to sovereigns could contribute to improving the definition of debt sustainability and thus reduce the prevalence of debt crises.

32. The Debt Sustainability Framework for low-income countries, jointly developed by the World Bank and IMF, tries to address these challenges by first estimating the long-run behaviour of several debt indicators and then checking the likelihood of those indicators crossing country-specific thresholds based on the World Bank's Country Policy and Institutional Assessment (CPIA) score. That approach does not exclude the possibility of making growth projections endogenous to debt accumulation, but it is not currently followed. This exercise is then used to put limits on the borrowing ability of low-income countries that are deemed to be at high risk of debt distress. Previous reports have highlighted several problems with this approach, especially with the use of the CPIA score to define debt thresholds (see A/63/181).

33. However, there has been limited discussion of the fact that the long-run estimations required by the Debt Sustainability Framework have almost no information content. As a result, important policy decisions are taken on the basis of extremely noisy signals. The designers of the Framework are well aware of this problem and have tried to address it by complementing baseline projections with a series of stress tests. This solution, however, does not consider the complex interactions between different shocks. Moreover, the stress tests focus only on what happens if the situation is worse than the baseline estimates. As a consequence, the Framework tends to be overly restrictive in limiting countries' capacity to borrow. Such an approach is appropriate only under the assumption that countries do not have many unexploited high-return investment opportunities.

34. Therefore, policymakers face a dilemma. Countries need to make borrowing decisions on the basis of forward-looking debt sustainability exercises. However, since such exercises tend to give noisy signals, countries may try to avoid debt crises by adopting overly restrictive borrowing policies that may hamper long-run growth.

[2] For instance, debt incurred to finance high-return investment projects can increase long-run growth and thus have a positive effect on debt sustainability. The same applies to debt incurred to stimulate aggregate demand during economic slumps. Finally, debt incurred to finance some forms of social expenditure may have a negative effect on debt sustainability but can hardly be defined as unnecessary. Debt sustainability also tends to be higher in countries that have large private saving rates.

Avoiding solvency crises by improving debt composition

35. A way out of the dilemma would be to explicitly recognize the inability to implement long-term forecasts and move towards a debt structure in which repayment is explicitly linked to a country's ability to pay. Greater use of debt denominated in local currency, debt indexed to GDP and debt indexed to commodity prices may play an important role in isolating countries from external shocks and thus increase debt sustainability without resorting to often misleading long-term projections (see A/62/151).

36. While such debt instruments do exist, they tend to be underutilized for essentially two reasons: adverse selection and political economy problems.[3] Bilateral and multilateral lenders could promote the use of debt contracts with repayment linked to the ability to pay by making greater use of such instruments and by educating the public and policymakers on the benefits of such types of debt contracts.[4]

Avoiding liquidity crises

37. Liquidity crises can lead to multiple equilibria. In the best-case scenario, a solvent borrower has continuous access to finance and remains solvent. In the worst-case scenario, the sudden withdrawal of financial resources caused by panicked lenders can push an otherwise solvent borrower towards insolvency.

38. The risk of liquidity crises can be reduced with domestic or international policies. The most basic domestic policy consists of accumulating international reserves, a form of self-insurance. One problem with self-insurance is that not all countries can afford it. Moreover, self-insurance may have large fiscal costs if the domestic interest rate is higher than that paid on the reserve assets (typically United States Government bonds).[5] While individually rational, self-insurance through reserve accumulation is an inefficient global response to systemic deficiencies in the global order of currency and finance. A more coherent global financial system could reduce the need for self-insurance and potentially liberate important resources.

39. A superior solution would be the creation of a well-functioning international lender of last resort complemented by domestic and international capital account management policies aimed at limiting destabilizing capital flows. An effective international lender of last resort can avoid the bad equilibrium by committing to provide financing if a liquidity crisis arises. In order to be successful, however, the lender needs to have the capacity to mobilize large sums and provide funds when no other lender has the ability or willingness to provide the volume of resources necessary to deal with a widespread liquidity crisis.

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[3] For a detailed discussion see footnote 2. In addition, through its Development Account project on building capacities to address financial implications of external shocks and climate change mitigation through innovative risk-management instruments, UNCTAD is providing support to debt management offices interested in developing sounder risk management techniques and moving towards issuing contingent debt instruments.

[4] The French Development Agency has been at the forefront in designing and utilizing these types of contracts. See Daniel Cohen, Hélène Djoufelkit-Cottenet, Pierre Jacquet and Cécile Valadier, "Lending to the poorest countries: a new counter-cyclical debt instrument", Working Paper No. 269 (Paris, Organization for Economic Cooperation and Development Centre, 2008).

[5] For a discussion of the costs and benefits of reserve accumulation, see *Trade and Development Report, 2009* (United Nations publication, Sales No. E.09.II.D.16).

40. An effective international lender of last resort needs to have three characteristics: speed, certainty, and power. The conditionality embedded in traditional IMF loans is inconsistent with the first two characteristics. The new IMF flexible credit line has the needed speed and certainty because it can provide large amounts of rapid financing with no ex post conditionality. This is clearly a step in the right direction, and it is not surprising that the flexible credit line has been described as one of the main changes in how IMF cooperates with its members. The main problem with the flexible credit line, however, is that its ex-ante conditions are so tight that almost no country needing the facility qualifies for it: as at July 2010, only three countries had joined (Colombia, Mexico and Poland).

41. IMF was created with the objective of solving balance-of-payments crises in an environment characterized by fixed exchange rates and limited capital mobility. IMF has been slow to adapt to a financially globalized world characterized by capital account crises from a world in which most crises were driven by slow-moving fundamentals affecting a country's current account.[6] Moreover, IMF has a legitimacy problem linked to its outdated ownership structure. It is for those reasons that some countries have moved towards regional monetary cooperation arrangements that explicitly recognize the presence of cross-border externalities and have a better understanding of the specific conditions and concerns of member countries. While such arrangements should be promoted and encouraged, they are not well suited to deal with shocks that affect a whole region. They should therefore be seen as a complement and not as an alternative to a global solution.

Dealing with solvency crises

42. Solvency crises are characterized by a unique equilibrium in which insolvent borrowers need to restructure their debt. In this case, an international lender of last resort cannot re-establish solvency without losing its funds, but a mechanism for the resolution of sovereign defaults can facilitate such a debt-restructuring process.

43. UNCTAD was the first international organization to call for an orderly workout procedure for the external debt of developing countries, drawing on national bankruptcy law, in 1986. In the aftermath of the Brady debt exchanges, the fear that the presence of a large number of dispersed and heterogeneous creditors could lead to long and costly debt renegotiations motivated several proposals aimed at reducing collective action problems. The debate culminated in 2001 with a proposal by IMF to create a sovereign debt restructuring mechanism.

44. The establishment of a sovereign debt restructuring mechanism was eventually rejected in favour of the use of collective action clauses. Opponents of the mechanism emphasized that restructuring bonded debt was not as difficult as is often claimed and suggested that the establishment of such a mechanism could have hampered the international debt market because costly defaults create a willingness to repay and any policy aimed at reducing those costs could shrink international lending or make it more expensive.

45. These arguments are flawed because the inefficiencies of the current system go well beyond the lack of coordination among creditors. Of course, an impartial

[6] This is not to say that policies aimed at limiting current account imbalances are not necessary. The centre point of such policies would be a system for avoiding large misalignments of the real exchange rate. For a proposal in that regard, see *Trade and Development Report, 2009*.

mechanism for the resolution of sovereign defaults could facilitate debt restructuring by mediating between lenders and borrowers and, by avoiding the holdout problem, guarantee a speedy and fair allocation of claims. But the real reason such a reform is needed is that the current non-system leads to a substantial destruction of value. Therefore, it is possible to devise institutions and policies that can reduce the costs of defaults while increasing recovery values on defaulted debt and thus increase access to credit and reduce the overall costs of borrowing.

46. During a typical default episode, the affected country often loses access to international credit, including trade credit. This reduces the country's exports and, by limiting capacity to pay, hurts both lenders and borrowers. While the destruction of value can be avoided by providing bridge financing during the debt restructuring process, this policy would require the capacity to make new loans senior with respect to old claims and the ability of imposing standstills on international payments in order to avoid the siphoning out of new financing. More generally, the possibility of creating a seniority structure on existing and future claims could avoid debt dilution in the pre-default phase and facilitate catalytic financing in the post-default period.

47. While the economic literature tends to assume that countries default too often and too early, there are cases in which countries suboptimally delay default, possibly to protect their reputation. Again, this may lead to a destruction of value because a prolonged pre-default crisis may reduce both the ability and the willingness to pay. There should be a mechanism for certifying and quantifying the need for debt restructuring, which could potentially protect the reputation of defaulters without forcing them to go through a painful postponing exercise, which ends up hurting both creditors and debtors.

48. To be sure, these are complex tasks, and their difficulty is amplified by the fact that potential political pressures tend to favour certain countries. This should not, however, be an excuse for inaction. With an average duration of four years, the debt restructuring process remains slow, costly and inefficient. The problem is particularly serious in low-income countries where the restructuring of commercial debt takes much longer than in middle-income countries and where debt restructuring does not contribute to debt sustainability (countries exit default with debt ratios that are on average higher than when they entered it).

49. Liquidity and solvency crises need different responses and, in theory, can be dealt with by different institutions. Those institutions are, however, complementary.

V. Debt relief and official development assistance

50. Debt relief and official development assistance provide a crucial cushion to developing countries in times of difficulty. Encouraging progress has been made in the past year with respect to the delivery of debt relief to heavily indebted poor countries. However, because of the global financial crisis and the volatility of aid flows, there is still concern regarding the increased debt vulnerabilities of many developing countries.

Debt relief

51. From July 2009 to July 2010, one country reached the decision point and six countries reached the completion point under the enhanced Heavily Indebted Poor Countries Initiative and benefited from additional debt relief under the Multilateral Debt Reduction Initiatives. Out of the 40 eligible countries, 30 have now reached the completion point, 6 have reached the decision point and 4 have yet to begin the Heavily Indebted Poor Countries Initiative. Nearly all of the countries that have yet to complete the Initiative are classified as fragile economies by the World Bank, indicating their need for additional assistance to expedite relief.

52. During the same period, seven Paris Club meetings were held, all of them devoted to treating the debt of heavily indebted poor countries.

53. In July 2009, Haiti rescheduled its Paris Club debt after reaching the decision point under the Initiative in June 2009. On a bilateral and voluntary basis, Paris Club creditors decided to go beyond the standard debt cancellation under the Initiative and wrote off an additional $152 million of Haiti's official bilateral debt, thus erasing the entire stock of eligible debt owed to the Paris Club. In the aftermath of the devastating earthquake that hit the country on 12 January 2010, Haiti received substantial debt relief from its bilateral and multilateral creditors.[7]

54. The Central African Republic reached the completion point in June 2009, paving the way for a Paris Club meeting in September 2009. Following the cancellations within the Heavily Indebted Poor Countries Initiative and additional relief granted by a number of creditors on a bilateral basis, the country's debt stock owed to Paris Club creditors was reduced from $59.3 million in June 2009 to $3.7 million following the meeting.

55. In November 2009, the Comoros concluded an agreement with the Paris Club creditors to reschedule its debt under the Naples terms. Moreover, exceptional treatment was applied so that payments to the Paris Club creditors were decreased by 80 per cent between July 2009 and June 2012. Paris Club creditors have committed to providing further debt relief, namely, reducing by an additional 50 per cent the debt service falling due, once the country reaches the decision point under the Heavily Indebted Poor Countries Initiative.

56. In February 2010, the Democratic Republic of the Congo reached an agreement with its Paris Club creditors to reschedule debt payments falling due between 2009 and 2012. The pre-cut-off-date debt was rescheduled under the Cologne terms, producing debt relief of 90 per cent during the consolidation period. Moreover, post-cut-off-date debt was also treated, including a deferral of arrears on short-term debt.

57. Following the attainment of the completion point under the Heavily Indebted Poor Countries Initiative in January 2010, Paris Club creditors met with representatives of Afghanistan in March 2010. The country obtained a 100 per cent write-off on its pre-cut-off-date debt, which included additional debt cancellations granted by creditors on a voluntary and bilateral basis. The agreement with the Paris Club creditors includes a comparability of treatment clause.

[7] For an evaluation of the debt situation of Haiti at the time of the earthquake, see UNCTAD Policy Briefs, No. 11, "Haiti's recovery should start with cancelling its debt", January 2010. Available from www.unctad.org.

58. In March 2010, a Paris Club meeting was held to consider the debt situation of the Congo after it reached the completion point in the Heavily Indebted Poor Countries Initiative in January. The country obtained a complete cancellation of its stock of eligible debt, with the provision that it keep the Paris Club secretariat informed of the progress made with other creditors for the next three years. That meeting highlighted the controversial role played by vulture funds in the international financial system. The amounts involved, around $500 million, were large, and the Congo obtained a minimum discount on those amounts.

59. In July 2010, Guinea-Bissau concluded an agreement with Paris Club creditors to reschedule its debt under the Cologne terms, thus reducing by 98 per cent the debt service falling due between January 2010 and December 2012. As part of the agreement, the country obtained a deferral until December 2012 of payments on its short-term and post-cut-off-date debts, including a deferral of moratorium interest. This treatment is intended to support adjustment efforts in Guinea-Bissau until it reaches the completion point under the Heavily Indebted Poor Countries Initiative.

60. The limited participation of non-Paris Club official creditors in the debt relief process and litigation by commercial creditors remain obstacles to minimizing the risk of future debt-servicing difficulties of heavily indebted poor countries. UNCTAD has repeatedly called upon the international community to address the problems raised by the litigious actions of vulture funds and the disruptive nature of their activities, in particular in the context of the Heavily Indebted Poor Countries Initiative. Although there are indications that IMF is currently examining ways to provide help in the future to countries faced with vulture fund claims, at this stage it is unclear what this help might entail and whether it will be sufficient to adequately deal with such problems in the future.

61. Seychelles provides an example of successful coordination between bilateral creditors, commercial lenders and multilateral lenders. Seychelles entered the global crisis with large imbalances, and in the third quarter of 2008 defaulted on its external bonds. The default was followed by a Paris Club meeting in April 2009, which led to an agreement involving debt rescheduling and net present value reduction (see A/64/167, para. 38). The Paris Club agreement opened the way for a successful bond exchange, in February 2010, facilitated by a partial credit guarantee provided by the African Development Bank.

62. At least six of the post-completion-point heavily indebted poor countries continue to show signs of debt distress, and three are not expected to reach sustainable positions in the medium term. Continued and increased access to concessional financing is required for countries to maintain debt sustainability beyond the completion point over the longer term. In the light of the negative consequences of the global crisis, efforts should be made to ensure that all eligible countries benefit from debt relief under the Heavily Indebted Poor Countries and Multilateral Debt Reduction Initiatives.

Official development assistance

63. Official development assistance (ODA) provides an important source of financing for the least developed countries, particularly for the pursuit of the Millennium Development Goals, as they often lack the space to broaden their tax base, while facing high GDP growth volatility and fragile revenue bases. Repeated

calls have been made for donors to increase ODA contributions to the 0.7 per cent of GNI target, which was reaffirmed at the 2000 Millennium Summit.

64. Net disbursements of ODA by donors to the Development Assistance Committee of the Organization for Economic Cooperation and Development (OECD) rose slightly, by 0.67 per cent in real terms to $123 billion in 2009. While some donors delivered on their existing ODA commitments and increased their ODA disbursements accordingly, those increases were offset by drastic cuts from some large Development Assistance Committee donors. As the global financial crisis continues to unfold, the empirical evidence of past crises suggests that a decline in ODA is likely for 2010.[8] In fact, some donors have already trimmed their budget lines for foreign aid.

65. According to OECD estimates, the Gleneagles aid targets, adopted by the Group of Eight at its 2005 summit, to increase aid to developing countries by $50 billion to $130 billion and to Africa by $25 billion by 2010 (in constant 2004 prices) are not likely to be achieved. The OECD estimates that there will be a $14 billion shortfall in the total ODA target and a $17 billion shortfall for Africa in 2010. In addition, the share of aid going to the least developed countries will most likely be considerably lower than the envisaged lower boundary of 0.09 per cent of donors' GNI. Given the enormous challenges for the achievement of the Millennium Development Goals as well as the important role of ODA in the least developed countries, the estimated shortfalls to committed aid targets are a serious setback for poverty reduction in the poorest nations.

66. The quality of aid and the modes of delivery are increasingly seen as being as important as its volume. Interest has been building towards ensuring that the efforts of donors are coordinated and aligned to increase the potential impact of aid. Both the Accra Agenda for Action (A/63/539, annex) and the Paris Declaration on Aid Effectiveness have aid effectiveness targets set for 2010.

67. Considerable progress has been made towards untying aid, and 79 per cent of Development Assistance Committee bilateral aid was untied by 2007. There has been less progress in the area of increasing aid predictability. Aid uncertainty, measured by the gap between commitments and disbursements, has grown considerably since 2002, as has aid volatility, with no sign of improvement. The situation may get even worse if, in the forthcoming years, the latest fiscal austerity measures introduced in many Development Assistance Committee countries negatively affect ODA.

68. These are worrisome trends, as there is evidence that both aid uncertainty and aid volatility have a negative impact on aid effectiveness and on economic growth. The predictability of aid flows could be enhanced by financing aid with the interest earnings on ODA-specific endowments.

69. While poverty reduction and development aid are at the heart of the Millennium Development Goals, stepped-up aid for achieving the Goals should not come at the expense of ODA for economic infrastructure and productive sectors. Progress in the area of aid effectiveness also requires increasing the share of aid targeted to the development of productive capacities and aimed at stimulating

[8] See UNCTAD Policy Briefs, No. 7, "Keeping ODA afloat: no stone unturned", March 2009. Available from www.unctad.org.

structural change and economic growth. Aid flows to economic sectors and infrastructure can induce synergies between the public and private sectors (as, for instance, in the Infrastructure Consortium for Africa) and leverage domestic investment.

VI. Policy conclusions

70. One positive surprise of the global financial crisis was the resilience of several developing countries. This resilience, however, risks being short-lived if the economic recovery falters and developing countries exhaust their limited policy space. In particular, developing countries are quickly running out of fiscal space, which may force them into a counterproductive fiscal contraction. The least developed countries and small, vulnerable low- and middle-income economies are at particular risk. It is imperative that the international community continue to support those countries with grants, increased access to concessional financing and, when necessary, debt relief. Budgetary problems in the advanced economies should not be used as an excuse for cutting foreign aid, which already absorbs a minuscule portion of the total fiscal outlay of most donor countries. Reneging on aid commitments and abandoning global solidarity at a time in which many developing countries are being hit by large negative external shocks is a nearsighted policy that can only lead to a losing outcome for all.

71. Debt crises tend to be costly and disruptive, especially for the poor and other vulnerable social groups. Debt crises also have a negative impact on access to schooling and health services, reducing human capital accumulation and long-run economic growth. Therefore, policies aimed at mitigating the prevalence and cost of debt crises can yield large payoffs in terms of poverty reduction and can play a key role in contributing to progress towards achieving the Millennium Development Goals. Such policies involve the promotion of newer and safer debt instruments; regulation aimed at reducing destabilizing capital flows; the creation of an effective international lender of last resort; the design of a set of guidelines aimed at limiting solvency crises by promoting responsible sovereign borrowing and lending to sovereigns; and the design of a mechanism for dealing with sovereign debt crises (see resolution 63/303).

72. In addition to the formulation of new policies to mitigate the cost of debt crises, a review of existing policies and frameworks is also needed. In particular, a review of the use and role of the Debt Sustainability Framework is warranted in the light of its central role in determining the availability and the terms on which resources are delivered to developing countries.

73. While reforming the financial architecture along the lines outlined above is a challenging task with many technical and political problems, there are several easy-to-implement actions that could have a positive impact on systemic stability. Data collection and reporting is one example. While having timely and comprehensive data on the level and composition of debt is a necessary condition for building early warning systems aimed at limiting the impact of debt crises, cross-country data on the level of external debt of developing countries are available only with a one-year lag; there is no comprehensive cross-country dataset covering the level and composition (by currency and maturity) of domestic debt, and information on subnational debt is often impossible to find. The official sector should intensify its

efforts to collect and disseminate those data, and donors should increase their support of technical cooperation programmes aimed at increasing the capacity of debt management offices to report timely, comprehensive and accurate debt statistics.[9] This is a field in which debt activists have been largely absent. Good data help in formulating good policies, and building good statistical offices may be more effective in contributing to development than other, more fashionable, policy interventions.

[9] The two leading technical assistance programmes in this field are the UNCTAD Debt Management and Financial Analysis System programme and the Debt Management Section of the Commonwealth Secretariat. The prevalence of debt crises could also be reduced by improving the governance structure and increasing the technical capacity of debt management offices in developing countries. The World Bank's Debt Management Facility plays an important role in assessing debt management performance and in advising countries in the implementation of appropriate debt management strategies.

Annex

External debt indicators

(Billions of United States dollars)

	All developing countries and countries with economies in transition						*Sub-Saharan Africa*					
	1990-1994	*1995-1999*	*2000-2006*	*2007*	*2008*	*2009*	*1990-1994*	*1995-1999*	*2000-2006*	*2007*	*2008*	*2009*
Total debt stocks	1 426.2	2 043.8	2 436.0	3 448.0	3 720.0	3 749.8	190.4	226.6	210.7	189.0	196.0	185.1
Long-term debt	1 155.6	1 642.2	1 951.2	2 579.0	2 846.0	2 874.8	156.8	177.4	173.1	141.0	143.0	145.6
Private (share)	47.1	54.3	62.2	74.5	75.6	74.0	24.6	24.0	22.4	34.1	33.3	32.0
Private non-guarantee (share)	8.6	21.8	32.3	48.2	51.6	49.8	4.2	5.6	5.6	11.6	10.0	10.2
Short-term debt	233.4	335.7	413.3	856.9	843.6	821.7	26.4	41.3	31.6	44.7	48.4	33.3
Arrears	114.5	116.0	89.0	74.0	75.9	—	40.4	60.1	40.3	37.5	35.4	—
Debt service	141.7	263.9	403.6	539.9	602.3	—	10.0	14.7	14.9	18.8	13.6	—
International reserves	253.8	554.8	1 432.6	3 852.7	4 330.9	4 893.1	14.8	24.6	56.6	141.5	151.2	150.8
Debt indicators (percentage)												
Debt service/exports	19.4	21.3	16.8	11.3	10.4	—	12.7	15.2	9.2	5.8	3.4	—
Total debt/exports	194.6	162.3	100.1	71.5	64.1	82.4	243.9	234.8	125.1	57.0	49.3	66.6
Debt service/GNP	3.7	5.0	5.3	3.9	3.6	—	3.4	4.5	3.3	2.3	1.4	—
Total debt/GNP	37.0	38.3	31.8	24.5	22.0	23.5	65.9	69.5	44.7	22.4	20.3	21.4
Reserves/short-term debt	104.0	162.1	340.2	440.5	503.7	581.0	58.4	61.8	187.4	332.9	327.5	452.7
Reserves/M2	14.2	19.3	24.7	32.2	32.2	29.4	13.5	21.1	28.6	34.7	37.7	31.4

	Middle East and North Africa						*Latin America and Caribbean*					
	1990-1994	*1995-1999*	*2000-2006*	*2007*	*2008*	*2009*	*1990-1994*	*1995-1999*	*2000-2006*	*2007*	*2008*	*2009*
Total debt stocks	124.4	131.0	130.1	141.0	132.0	130.7	468.8	672.4	757.3	839.0	894.0	915.3
Long-term debt	103.6	114.4	111.1	118.0	111.0	111.3	361.8	529.8	635.1	684.0	735.0	775.5
Private (share)	37.3	26.1	35.1	40.9	39.7	35.5	65.8	74.9	79.1	83.3	83.1	80.9
Private non-guarantee (share)	0.8	1.6	4.0	5.2	5.3	5.6	12.1	31.3	35.8	41.8	43.9	42.9
Short-term debt	19.1	13.9	17.4	23.5	20.0	19.2	91.3	120.0	97.2	154.0	158.0	138.6
Arrears	4.9	2.3	0.8	0.3	0.3	—	40.2	10.8	20.1	25.1	28.1	—
Debt service	17.7	18.0	19.4	19.3	21.1	—	49.3	116.5	158.1	153.0	155.0	—
International reserves	34.4	61.1	161.6	382.8	452.9	464.1	83.2	153.6	204.3	437.4	486.7	537.0
Debt indicators (percentage)												
Debt service/exports	29.3	25.2	13.0	6.6	6.0	—	27.6	37.8	31.6	18.0	15.6	—
Total debt/exports	206.3	183.6	86.9	48.0	37.5	48.7	257.9	215.9	149.6	98.4	89.9	116.1
Debt service/GNP	7.9	5.9	4.5	2.7	2.5	—	4.1	6.4	7.6	4.4	3.8	—
Total debt/GNP	55.3	42.7	30.4	19.6	15.3	15.2	38.4	36.7	35.8	24.0	21.8	23.9
Reserves/short-term debt	121.0	322.0	693.8	1208.0	1707.9	1799.5	89.3	127.2	209.6	282.7	306.6	387.0
Reserves/M2	18.8	27.4	45.6	58.0	61.0	56.5	15.1	23.5	19.9	21.2	24.6	20.4

	East Asia and Pacific						*South Asia*					
	1990-1994	*1995-1999*	*2000-2006*	*2007*	*2008*	*2009*	*1990-1994*	*1995-1999*	*2000-2006*	*2007*	*2008*	*2009*
Total debt stocks	300.4	509.6	564.0	750.0	772.0	791.7	137.8	155.0	182.0	289.0	326.0	317.2
Long-term debt	239.6	396.0	407.4	460.0	497.0	489.5	121.6	143.4	170.6	243.0	270.0	259.0
Private (share)	47.5	59.3	57.3	61.6	61.1	61.2	24.7	27.9	36.7	47.6	48.6	42.8
Private non-guarantee (share)	15.6	32.2	34.9	43.9	44.5	43.8	2.7	7.1	24.6	40.5	41.1	35.9
Short-term debt	59.2	105.5	145.9	290.0	274.0	302.0	9.7	8.3	8.9	43.7	51.3	49.1
Arrears	8.4	15.4	14.7	7.0	7.0	—	0.1	0.5	0.2	0.4	0.3	—
Debt service	37.4	62.8	83.7	93.1	96.9	—	12.1	16.6	22.1	43.7	36.6	—
International reserves	90.0	218.5	666.2	1 835.5	2 266.5	2 706.4	13.6	31.3	111.9	293.3	267.0	294.7
Debt indicators (percentage)												
Debt service/exports	16.2	13.6	8.6	4.7	4.2	—	29.7	25.0	15.9	15.4	10.5	—
Total debt/exports	130.2	110.5	58.2	37.6	33.1	40.4	338.9	234.0	131.2	100.7	93.3	106.5
Debt service/GNP	4.6	4.4	3.5	2.1	1.7	—	3.2	3.2	2.7	3.0	2.4	—
Total debt/GNP	37.2	35.5	23.4	16.8	13.8	13.3	36.6	29.5	22.4	20.0	21.3	20.2
Reserves/short-term debt	152.0	207.3	456.3	633.1	826.1	896.3	140.6	375.1	1 263.5	672.0	520.8	599.7
Reserves/M2	13.4	15.1	20.7	28.7	28.8	27.3	8.4	13.3	22.7	28.4	26.3	23.9

	Europe and Central Asia					
	1990-1994	*1995-1999*	*2000-2006*	*2007*	*2008*	*2009*
Total debt stocks	204.4	349.2	591.9	1 240.0	1 400.0	1 409.7
Long-term debt	172.2	281.2	453.9	933.0	1 090.0	1 093.9
Private (share)	49.1	52.5	74.3	91.9	92.9	91.7
Private non-guarantee (share)	4.6	15.2	45.0	68.1	72.8	70.6
Short-term debt	27.6	46.8	112.2	301.0	292.0	279.5
Arrears	20.6	27.0	13.0	3.7	4.7	—
Debt service	15.1	35.4	105.3	212.0	279.0	—
International reserves	17.8	65.7	232.1	762.3	706.6	740.2
Debt indicators (percentage)						
Debt service/exports	—	14.4	21.4	20.3	20.6	—
Total debt/exports	—	137.7	118.2	118.0	102.6	147.6
Debt service/GNP	—	4.1	7.6	7.0	7.4	—
Total debt/GNP	—	38.9	41.7	40.6	36.9	48.5
Reserves/short-term debt	—	149.9	212.4	255.8	246.0	264.8
Reserves/M2	—	31.7	45.9	53.2	49.5	47.1

Source: UNCTAD calculations based on *Global Development Finance: External Debt of Developing Countries* (Washington, D.C., International Bank for Reconstruction and Development, 2010).